

TEACHERS' RETIREMENT BOARD

REGULAR MEETING

SUBJECT: Update on Federal Legislation

ITEM NUMBER: 6b

ATTACHMENT(S): 3

ACTION: X

MEETING DATE: June 6, 2002

INFORMATION:

PRESENTER: Ed Derman

SUMMARY

Congressional activity in response to the Enron meltdown has progressed beyond the hearing stage to the legislative stage. The legislative measures that are currently being evaluated are summarized below and discussed in greater detail in the attached report.

Investor Protection and Accounting Oversight Legislation

- **House Legislation**

On April 24, the House of Representatives passed the "Corporate and Auditing Accountability, Responsibility, and Transparency Act" (H.R. 3763), sponsored by House Financial Services Committee chair Michael Oxley (R-Ohio). The legislation would make numerous modifications in the regulation of the accounting profession and also provides for improved corporate disclosure to investors. In the course of its "mark-up" of this legislation, however, the House Financial Services Committee rejected a number of amendments, generally along party lines, that involved initiatives adopted by the Board in the development of its corporate governance action plan.

The House Energy and Commerce Committee is struggling to create a bipartisan measure that seeks to assure the independence and financial viability of the Financial Accounting Standards Board (FASB).

- **Senate Legislation**

On the Senate side, Senate Majority Leader Tom Daschle (D-S.D.) currently plans to package the separate legislative measures regarding investor protection/accounting oversight, securities fraud reform, and pension security into a single omnibus bill for consideration on the Senate Floor this summer.

Banking Committee Chairman Sen. Paul Sarbanes has created a discussion draft of investor protection and accounting reform legislation that builds upon the package (S.

2004) introduced by Sens. Chris Dodd (D-Conn.) and Jon Corzine (D-N.J.) known as “The Investor Confidence in Public Accounting Act of 2002”. This legislation concerns federal regulation of accounting, treatment of stock options on financial statements and financial disclosures.

Chairman Sarbanes’s package is known as the “Public Company Accounting Reform and Investor Protection Act of 2002”.

Key features of the proposal are as follows:

- New accounting oversight board
- Independent accounting principles
- Independence of auditors
- Corporate governance and management responsibility
- Enhanced financial disclosures
- Analyst conflicts of interest
- Insider trading during blackout periods
- SEC resources and authority

Corporate Governance Reform Legislation

Sen. Carl Levin (D-Mich.), Chairman of the Senate Governmental Affairs Subcommittee on Permanent Investigations, has spearheaded an inquiry into the Enron debacle from a corporate governance perspective. He also lead the controversial legislation requiring the expensing of stock options in corporate financial reporting, introduced on May 6, entitled the “Shareholder Bill of Rights” (S. 2460). The key features of the Shareholder Bill of Rights are as follows:

- Independent accounting standards
- Prompt issuance of accounting standards
- Auditor independence
- Company information needed for audit
- Audit committee oversight
- Shareholder proposals
- Shareholder approval of stock options
- Limits on preferential treatment, loans and gifts

The prospects are tentative for Sen. Levin’s corporate governance reform legislation. It has been referred to the Senate Banking Committee. The Committee will be focusing on Chairman Sarbanes’s investor protection/accounting reform package discussed above, which also includes some corporate governance provisions. Since Sen. Levin does not serve on the Banking Committee, it is unknown whether any of the provisions from his measure will be added to the package prepared by the Senate Banking Committee. The Banking Committee legislation would be subject to amendment on the Senate Floor, and that may be where Sen. Levin presents his provisions.

New SEC Rules on Stock Analyst Conflicts of Interest

The Securities and Exchange Commission has labored tremendously to keep active on the investor protection/accounting oversight front by adopting new regulations. The SEC's latest regulatory pronouncement was its May 8 approval of proposed changes to the rules of the National Association of Securities Dealers and the New York Stock Exchange to address the matter of stock analyst conflicts of interest. Key features of these new stock analyst conflict of interest rules include:

- Promises of favorable research
- Limitations on relationships and communications
- Analyst compensation
- Firm compensation
- Restrictions on personal trading by analysts
- Disclosures of financial interests in covered companies
- Disclosures in research reports regarding the firm's ratings
- Disclosures during public appearances by analysts

Securities Fraud Litigation Legislation

- **Senate Legislation**

The Senate Judiciary Committee on May 6, reported out to the full Senate S. 2010, the "Corporate and Criminal Fraud Accountability Act of 2002", drafted by Chairman Patrick Leahy (D-Vt.). Chairman Leahy's legislation has three major components: (1) additional tools for prosecutors to pursue fraud cases; (2) additional tools for regulators and investigators to collect and preserve evidence of fraud; and (3) additional tools for victims of fraud to recover compensation from those who perpetrated and aided the fraud. The proposal would enhance the existing patchwork of technical securities law violations with a more general and less technical provision, comparable to bank fraud statutes.

Pension Security Legislation

- **House Legislation**

The House of Representatives adopted a pension security package, H.R. 3762 (the "Pension Security Act of 2002") on April 11. This legislation incorporates competing versions of the legislation produced by the House Ways and Means Committee and the Education and Workforce Committee. The key features of the pension security legislation are as follows:

- Investment education and benefit statement
- Blackout notices

- Inapplicability of relief from fiduciary liability during suspension of ability of participants to direct investments
- Diversification
- Investment advice
- Parity for employees during blackouts

The California State Teachers' Retirement System (CalSTRS) continues to coordinate with the informal working group of State and local government organizations, including CalPERS, and with the Governor's office in Washington in working with Congressional staff in the Senate – as the Finance Committee staff works to put together corresponding legislation – to clarify several technical portions of these provisions.

- **Senate Legislation**

The Senate continues to move slowly in addressing this issue. In the Senate, pension jurisdiction is split between the Finance Committee, chaired by Sen. Max Baucus (D-Mont.), which handles the tax side, and the Health, Education, Labor, and Pensions Committee, chaired by Sen. Edward Kennedy (D-Mass.), which handles the ERISA side. Senate pension efforts are less coordinated between the two Committees, as Chairman Kennedy already has moved ahead with introduction (S. 1992) and mark-up of legislation while the Finance Committee continues to work to put together its own pension security package, which is expected to be more bipartisan.

Elk Hills Compensation

CalSTRS continues to work with House Ways and Means Committee Chairman Bill Thomas (R-Bakersfield) and Sen. Dianne Feinstein (D-Ca.) to pursue the necessary Congressional appropriation of the fifth \$36 million installment of Elk Hills compensation due for FY 2003. CalSTRS got a good start on this issue when President Bush requested the necessary appropriation for the fifth installment of Elk Hills compensation in his budget request to Congress for FY 2003.

CalSTRS has secured the signatures of the entire 52 Member California House delegation on a letter which has been sent to the House appropriators strongly supporting the appropriation for the fifth installment of Elk Hills compensation. (A copy of the letter is attached.) The next step in the process is the Committee mark-up of the Interior Appropriations legislation for FY 2003 by the House Interior Appropriations Subcommittee, chaired by Rep. Joe Skeen (R-N.M.). That mark-up is not expected until at least June, and may not occur until well into the summer.

Summary of Federal Legislation

Also attached is a summary of all federal legislation that contains provisions of interest to CalSTRS or its members, and their current status in Congress.

Mr. Derman will provide a verbal update at the meeting.

**MEMORANDUM FOR
THE CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM**

Washington Monthly Report

Investor Protection and Accounting Oversight Legislation

Since last month's report, Congress has moved past the hearing phase to the legislative phase of the response to the Enron debacle. The House has now passed its version of investor protection and accounting oversight legislation, criticized by some as a tepid response. In the Senate, a tougher investor protection and accounting oversight measure has been proffered in discussion draft form by Senate Banking Committee Chairman Paul Sarbanes (D-Md.). Senate Governmental Affairs Permanent Investigations Subcommittee Chairman Carl Levin (D-Mich.) has put forward a package aimed at corporate governance reform. Senate Banking Chairman Sarbanes hopes to move his package through Committee before the Memorial Day recess. The prospects for Sen. Levin's corporate governance reforms are more uncertain.

House Legislation

The full House of Representatives on April 24 passed the investor protection and accounting reform legislation drafted by House Financial Services Committee Chairman Michael Oxley (R-Ohio). The House legislation is known as the "Corporate and Auditing Accountability, Responsibility, and Transparency Act" (H.R. 3763). The legislation would make a number of changes in the regulation of the accounting profession as well as providing for enhanced corporate disclosure to investors. Critics have argued the legislation is tepid because it fails to provide for a strong oversight board for the accounting industry and fails to do enough to assure auditor independence.

On the accounting side, the measure would prohibit accounting firms from providing internal auditing and financial computer systems consulting services to their audit clients – though the lucrative tax consulting services could continue. A new five-member "public" regulatory board would be established to oversee the accounting profession. This new regulatory board would be "public" in the sense that three of the five members of the board would be comprised of persons not associated with the accounting profession and would operated under the "direct authority" of the Securities and Exchange Commission. (However, during markup

the Committee adopted an amendment defining “not associated with the accounting industry” as not having worked in the accounting industry within the past two years.) Accountants and their firms would be subject to "certification" by this new board and would have statutory authority to impose penalties on accountants who violate securities laws or standards of ethics, competency, or independence.

On the corporate disclosure side, the measure would require that off-balance sheet transactions be "fully disclosed". Corporate insiders would be required to inform the SEC and the public within a 1-2 day period after they sell company stock, rather than waiting up to 40 days under current law. Public companies would be required to make public disclosure "on a rapid and essentially contemporaneous basis, of information concerning the issuer's financial health and operations." It also would be made unlawful for any person associated with the company to "interfere" with the auditing process. The SEC would be required to conduct regular and thorough audit reviews of the largest and most widely traded companies. Finally, the legislation would require a number of studies, including stock analyst conflict of interest, corporate information disclosure, role of credit rating agencies, and corporate governance.

During the Financial Services Committee mark-up of the legislation, Democrats offered a slew of amendments seeking to toughen various aspects of Chairman Oxley's package. These Democratic amendments were generally rejected along a party-line vote. The Committee did adopt a number of noncontroversial amendments. The votes on these amendments – many of which involve initiatives supported by CalSTRS policy – are instructive regarding the level of support for these types of initiatives in the GOP-controlled House.

The Committee adopted amendments to:

- Ensure that studies mandated under the legislation regarding corporate governance, SEC enforcement actions, and rating agencies include legislative and regulatory recommendations;
- Apply new electronic disclosure rules to derivatives transactions;
- Require the General Accounting Office to study the role played by investment bankers and financial advisors in aiding the manipulation of earnings by public companies;
- Authorize the SEC to review whether additional categories of “non-audit” services should be added to the list of proscribed services by the auditor of a company and to authorize the SEC to issue rules implementing such new prohibitions;

- Give the new accounting regulatory body subpoena power through the SEC;
- Narrow the ban on sales of stock by corporate executives during “lock-down” periods affecting the retirement plan.

The Committee rejected amendments to:

- Prohibit accounting firms from providing 10 specific non-auditing services to companies they audit;
- Require the accounting firm to receive prior approval from the audit committee of the company’s board before offering any non-audit services;
- Require a 2-year cooling off period before an auditor could go to work for an audit client;
- Require SEC enforcement of audit committee governance practices, rather than relying on self-policing by industry and the stock exchanges;
- Provide the SEC with enhanced powers to remove board members of public companies for unfitness; barred an independent member of the board of directors from also working as a paid consultant to the company;
- Require executive stock option plans to be approved by a committee of independent directors who would be “responsible” to the shareholders;
- Require companies to switch auditors every 8 years.

Finally, the House Financial Services Committee authorized a 60 percent increase in the SEC's FY 2003 budget, to \$776 million. This budget increase, however, is subject to funding by the Congressional appropriators.

House Energy and Commerce Committee Chairman Billy Tauzin (R-La.), whose Committee jurisdiction in this area is largely limited to Financial Accounting Standards Board (FASB) issues, is struggling to put together a bipartisan proposal that seeks to assure the independence and financial viability of FASB. Thus far, he has been unable to reach agreement with Committee Democrats on the proper approach.

Senate Legislation

We understand that on the Senate side, Senate Majority Leader Tom Daschle (D-S.D.) presently intends to package the separate legislative measures regarding investor protection/accounting oversight, securities fraud reform, and pension security into a single omnibus bill for consideration on the Senate Floor this summer.

In the Senate, jurisdiction over investor protection and accounting oversight is more consolidated in the Banking Committee, chaired by Sen. Paul Sarbanes (D-Md.). Chairman Sarbanes has developed a discussion draft of investor protection and accounting reform legislation that builds upon the package (S. 2004) introduced by Sens. Chris Dodd (D-Conn.) and Jon Corzine (D-N.J.) that was described at length in last month's report. Chairman Sarbanes's package is known as the "Public Company Accounting Reform and Investor Protection Act of 2002".

Chairman Sarbanes's package at this juncture is not expected to be introduced as legislation, but rather will be offered as a Chairman's mark at the Senate Banking Committee mark-up which Chairman Sarbanes hopes to complete before Congress leave for the Memorial Day recess. The Committee may mark up Chairman Sarbanes's package as early as May 21. Though Chairman Sarbanes's package has not been officially released to the public, we have provided STRS staff with the summary, section-by-section description, and legislative language that were distributed to Committee Members in a private meeting last week.

In brief, Chairman Sarbanes's package establishes a stronger accounting oversight board than under the House legislation, seeks to promote the independence of outside auditors, provides for reforms in corporate governance and financial disclosure. Key features of the proposal, according to the official description, are as follows:

New Accounting Oversight Board

- The discussion draft addresses the needs of investors to restore confidence in public company financial reporting and their accountants by setting up a strong private sector board to oversee the public company auditing profession. It establishes a Public Company Accounting Oversight Board, as a private regulatory organization.
- The Board, overseen by the SEC, would have authority solely relating to the work of accounting firms auditing public.
- Members of the new Board would be appointed by the SEC after consultation with the Department of the Treasury and the Federal Reserve Board and according to the legislation's description must be

persons of integrity and reputation who have a demonstrated commitment to the interests of investors and the public. No more than two of its five members may have an accountancy background.

- The new oversight Board would establish its own budget and be independently funded by registered accounting firms and public companies as established by the Board and the Commission.
- The Board would have authority to establish or adopt auditing, quality control standards, and ethics rules to govern the conduct of audits for public companies. Auditors would be required to: (1) retain all audit work for seven years; (2) obtain 2nd partner review of audit reports; and (3) express an opinion on certain internal controls of public companies.
- The discussion draft provides for regular inspections by the Board of the work of registered public accounting firms, including annual inspections for the largest accounting firms (initially, those that audit more than 100 public companies). It further grants the Board full authority to investigate any act that may violate the Board or SEC's rules, the securities laws (including the new statute), or professional accounting standards.
- The Board, subject to SEC review, would be authorized to impose a full range of disciplinary or remedial sanctions if it finds that a registered accounting firm, or its partners or employees, have engaged in any act or practice that violates the Board's or SEC's rules, the securities laws or professional standards.

Independent Accounting Principles

- To better promote the effectiveness and independence of the accounting principles set by the Financial Accounting Standards Board ("FASB") the discussion draft (1) authorizes the SEC to recognize such a standard setting body; (2) provides for the secure funding of such body; (3) requires that it be selected by a board of trustees a majority of whom are not from the accounting profession; and (4) requires that the standard setting body set standards by majority rule.

Independence of Auditors

- To further promote the independence of public company auditors, the discussion draft restricts the non-auditing or consulting work that can be provided by auditors. The draft prohibits providing public company audit clients with: (1) financial information systems design; (2) internal audit work; (3) expert opinions; as well as (4) other categories of non-audit work previously restricted through SEC rules.
- The new Board is authorized to issue rules to implement these auditor independence provisions.
- All other non-audit work, including tax services, would be allowed if pre-approved by a public company's audit committee.
- The discussion draft would require the Congressional General Accounting Office (GAO) to study the merits of requiring audit firm rotation and report to Congress. The draft does call for the rotation of accounting firm partners providing auditing services for the same issuer for more than 5 consecutive years.
- A one-year "cooling off" period would be required prior to a public company hiring as its Chief Executive Officer or Chief Financial Officer someone who had just conducted its audit.

Corporate Governance and Management Responsibility

- The discussion draft would require audit committees to be responsible for the appointment, compensation, and work of auditors and hear directly from the auditors on key matters. Audit committees would have to be independent from management: have procedures to address complaints regarding auditing issues; and have authority to retain counsel and advisors.
- The draft includes the President's proposal requiring CEOs and CFOs to sign their company's audit report. Certifying that the financials fairly and accurately reflect the operations and financial condition of their companies, they would subsequently forfeit profits and bonuses realized in the 12 months before a material accounting restatement that occurs as a result of material noncompliance with securities laws.
- The discussion draft also strengthens the sanction of barring securities law violators from serving as officers or directors. District courts would be permitted to impose bars if directors or officers demonstrate "unfitness," (rather than "substantial unfitness") to serve.

- The discussion draft makes it unlawful for any officer, director, or affiliated person to fraudulently influence, coerce, manipulate or mislead any accountant preparing an audit report.

Enhanced Financial Disclosures

- The draft would further protect investors and promote transparent capital markets by enhancing a number of financial disclosures. It would require public companies to report loans to insiders on current reports filed with the SEC within seven calendar days or such other period determined by the SEC. Public companies would be required to present pro forma data in a manner not likely to mislead investors and clearly distinguished from GAAP financials. Public companies would be required to disclose off-balance sheet transactions and conflicts. Management and the company's auditor would be required to attest to the company's internal control procedures in the annual report. Insider trading would be required to be reported by the day following any transactions.
- The discussion draft also directs the SEC to make recommendations to the accounting standard-setting board as to how different types of stock options should be treated for financial reporting.

Analyst Conflicts of Interest

- The discussion draft requires the SEC to enact rules, or to direct the self-regulatory organizations to enact rules, to prohibit certain conflicts that could compromise a security analyst's independence and to disclose other potential conflicts in their research reports.
- Specifically, the draft proposes to (1) protect analysts from retaliation for making unfavorable stock recommendations (a protection not in the new NASD/NYSE rules); (2) prevent investment banking staff from supervising research analysts or clearing their reports; (3) prohibit an analyst from distributing research reports on companies their firm is presently underwriting; (4) reinforce informational safeguards (so called "Chinese Walls") between investment banking and research departments; and (5) address other issues as the SEC deems appropriate.
- The discussion draft would require an analyst to disclose (in public appearances and research reports): (1) any ownership of the company's stocks or bonds; (2) any compensation received from the company; (3) any client relationship with the company; (4) any compensation received by the analyst that is based on investment

banking revenues received from the company; and (5) such other facts as the SEC deems appropriate.

Insider Trading During Blackout Periods

- Directors, officers, or beneficial owners are prohibited from trading company stock during a “blackout” period when employees are prohibited from trading company stock held in individual retirement plans.

SEC Resources and Authority

- The discussion draft significantly increases the resources of the SEC by authorizing \$776 million for FY 2003 to fully fund pay parity, update computer technology, and hire more staff. It also codifies Section 102(e) of the SEC Rules of Practice to authorize the SEC to censure or deny the right to practice before the SEC to professionals who have violated the securities laws, engaged in improper professional conduct, or in other ways lack qualifications.

Corporate Governance Reform Legislation

In the Senate, Sen. Carl Levin (D-Mich.), Chairman of the Senate Governmental Affairs Subcommittee on Permanent Investigations, has spearheaded an inquiry into the Enron debacle from a corporate governance perspective. Chairman Levin hauled members of the Enron board of directors before a “show trial” hearing to find out what went wrong in a corporate governance sense. One Congressional observer compared the hearing to the case where the policeman pulls the car over for speeding and everyone is in the backseat, as one director after another said he had been ignorant or misinformed about possible Enron wrongdoing.

Sen. Levin – who also has spearheaded the controversial legislation requiring the expensing of stock options in corporate financial reporting – introduced on May 6 a far-ranging corporate governance reform package, entitled the “Shareholder Bill of Rights” (S. 2460).

The key features of Sen. Levin’s shareholder rights legislation, according to the official description, are as follows:

- **Independent Accounting Standards.** Establishes an independent source of funding for the non-governmental body authorized by SEC to issue accounting standards (currently the Financial Accounting Standards Board or “FASB”).

- **Prompt Issuance of Accounting Standards.** Requires the independent accounting standards body to resolve matters promptly, with due process and public participation. For any matter unresolved after two years, authorizes the SEC to require action by a date certain or to resolve the matter itself.
- **Auditor Independence.** Increases auditor independence by barring an audit firm from auditing its own work and from providing non-auditing services to a company during the course of its audit contract and for two years afterward.
- **Company Information Needed For Audit.** Directs SEC to issue rules requiring a publicly traded company to provide all material information to its auditor. Prohibits such companies from improperly influencing or misleading an auditor.
- **Audit Committee Oversight.** Directs SEC to issue rules requiring the audit committee of a publicly traded company to oversee the company's accounting practices and ensure that the financial statements are accurate.
- **Shareholder Proposals.** Directs SEC not to prohibit shareholder proposals permitted under state law to remove or replace a director, to retain or replace the company auditor, to ensure director independence, to require the audit committee chairman or company auditor to attend the shareholder annual meeting to answer questions, or to obtain disclosure of compensation information for any director or company officer.
- **Shareholder Approval of Stock Options.** Requires shareholder approval of any stock option compensation plan that will not be shown on company financial statements as an expense.
- **Limits on Preferential Treatment, Loans and Gifts.** Directs SEC to issue rules barring companies in cases of bankruptcy from providing preferential treatment on compensation benefits to company directors or officers compared to other employees or creditors of the company. Directs SEC to issue rules requiring improved disclosure of company loans to directors and officers and company contributions to or transactions involving persons affiliated with a board member.

As noted above, the prospects are uncertain for Sen. Levin's corporate governance reform legislation. It has been referred to the Senate Banking Committee, which will be focusing on Chairman Sarbanes's investor protection/accounting reform package discussed above and which does include some

corporate governance provisions. Since Sen. Levin does not serve on the Banking Committee, it remains to be seen whether any of the provisions from his measure will be added to the package marked up by the Senate Banking Committee. The Banking Committee legislation would be subject to amendment on the Senate Floor, and that may be where Sen. Levin makes his move.

New SEC Rules on Stock Analyst Conflicts of Interest

The Securities and Exchange Commission has struggled mightily to keep its oar in the water on the investor protection/accounting oversight front through new regulation. The SEC's most recent regulatory pronouncement was its May 8 approval of proposed changes to the rules of the National Association of Securities Dealers and the New York Stock Exchange to address the matter of stock analyst conflicts of interest.

Key features of these new stock analyst conflict of interest rules, according to the official description, include:

- **Promises of Favorable Research.** The rules changes will prohibit analysts from offering or threatening to withhold a favorable research rating or specific price target to induce investment banking business from companies. The rule changes also impose "quiet periods" that bar a firm that is acting as manager or co-manager of a securities offering from issuing a research report on a company within 40 days after an initial public offering or within 10 days after a secondary offering for an inactively traded company.
- **Limitations on Relationships and Communications.** The rule changes will prohibit research analysts from being supervised by the investment banking department. In addition, investment banking personnel will be prohibited from discussing research reports with analysts prior to distribution, unless staff from the firm's legal/compliance department monitor those communications. Analysts will also be prohibited from sharing draft research reports with the target companies, other than to check facts after approval from the firm's legal/compliance department.
- **Analyst Compensation.** The rule changes will bar securities firms from tying an analyst's compensation to specific investment banking transactions. Furthermore, if an analyst's compensation is based on the firm's general investment banking revenues, that fact will have to be disclosed in the firm's research reports.

- **Firm Compensation.** The rule changes will require a securities firm to disclose in a research report if it managed or co-managed a public offering of equity securities for the company or if it received any compensation for investment banking services from the company in the past 12 months. A firm will also be required to disclose if it expects to receive or intends to seek compensation for investment banking services from the company during the next 3 months.
- **Restrictions on Personal Trading by Analysts.** The rule changes will bar analysts and members of their households from investing in a company's securities prior to its initial public offering if the company is in the business sector that the analyst covers. In addition, the rule changes will require "blackout periods" that prohibit analysts from trading securities of the companies they follow for 30 days before and 5 days after they issue a research report about the company. Analysts will also be prohibited from trading against their most recent recommendations.
- **Disclosures of Financial Interests in Covered Companies.** The rule changes would require analysts to disclose if they own shares of recommended companies. Firms will also be required to disclose if they own 1% or more of a company's equity securities as of the previous month end.
- **Disclosures in Research Reports Regarding the Firm's Ratings.** The rule changes will require firms to clearly explain in research reports the meaning of all ratings terms they use, and this terminology must be consistent with its plain meaning. Additionally, firms will have to provide the percentage of all the ratings that they have assigned to buy/hold/sell categories and the percentage of investment banking clients in each category. Firms will also be required to provide a graph or chart that plots the historical price movements of the security and indicates those points at which the firm initiated and changed ratings and price targets for the company.
- **Disclosures During Public Appearances by Analysts.** The rule changes will require disclosures from analysts during public appearances, such as television or radio interviews. Guest analysts will have to disclose if they or their firm have a position in the stock and also if the company is an investment banking client of the firm.

Securities Fraud Litigation Legislation

On May 6, the Senate Judiciary Committee reported out to the full Senate S. 2010, the "Corporate and Criminal Fraud Accountability Act of 2002", drafted by Chairman Patrick Leahy (D-Vt.).

Chairman Leahy's proposal has three principal components: (1) additional tools for prosecutors to pursue fraud cases; (2) additional tools for regulators and investigators to collect and preserve evidence of fraud; and (3) additional tools for victims of fraud to recover compensation from those who perpetrated and aided the fraud.

The legislation would supplement the current patchwork of technical securities law violations with a more general and less technical provision, comparable to bank fraud statutes. The legislation simply would make it a felony to "defraud any person in connection with any security of any issuer with a class of securities [registered under section 12 or required to file reports under section 15(d) of the Securities and Exchange Act]." The new securities fraud felony also would apply to any effort "to obtain, by false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of any [such issuer]." The new felony would be punishable by up to 10 years in prison.

During the Judiciary Committee mark-up of S. 2010, the Committee dropped the provision that would have authorized State attorneys general and the SEC would now be authorized, along with the U.S. Attorney General, to bring civil RICO actions with treble damages for securities fraud.

The sentencing guidelines would be made more stringent for fraud cases in which evidence was destroyed or fabricated, large numbers of investors were harmed, or where the harm to investors was particularly grave. The measure would make it a crime to destroy evidence in a federal investigation of a securities fraud case involving a publicly-traded company.

This legislation would extend the period of limitations for securities fraud cases brought by investors against public corporations to the earlier of five years after the date of the fraud or two years after the fraud was discovered (reduced from three years in the introduced legislation). The measure also would limit the ability of those who have committed securities fraud to use the shield of bankruptcy against investor suits. Finally, new "whistleblower" protections would be provided for employees of public companies in connection with disclosure of fraud to regulators.

Pension Security Legislation

House Legislation

On April 11, the House of Representatives passed the first piece of legislation responding to the Enron debacle by adopting a pension security package, H.R. 3762 (the "Pension Security Act of 2002"). This legislation melded together competing versions of the legislation produced by the House Ways and Means Committee, chaired by Rep. Bill Thomas (R-Bakersfield), and the Education and Workforce Committee, chaired by Rep. John Boehner (R-Ohio).

The key features of the House pension security legislation, according to the official description, are as follows:

Investment Education and Benefit Statement:

- The bill requires the plan administrator of a self-directed defined contribution plan to provide an annual notice to plan participants and beneficiaries of the value of investments allocated to their individual account, including their rights to diversify any assets held in employer securities. Defined benefit plans would have to provide a benefit statement at least one every 3 years to be a participant.
- The notice will also include an explanation of the importance of a diversified investment portfolio including a risk of holding substantial portions of a portfolio in any one security, such as employer securities.
- The Secretary of Treasury will issue guidance and model notices that include the value of investments, the rights of employees to diversify any employer securities and an explanation of the importance of a diversified investment portfolio. Initial guidance will be no later than January 1, 2003. The Secretary may also issue interim model guidance.
- Notice may be electronic if reasonably accessible to the recipient.

Blackout Notices:

- The bill requires a new notice 30 days prior to any suspension of participant and beneficiaries ability to direct or diversify assets. The notice must contain the reasons for the suspension, as well as a statement that the administrator has evaluated the reasonableness of the expected period, and a statement that the participant should evaluate the appropriateness of their current investment decisions in

light of their inability to direct or diversify assets during the expected period of suspension.

- The bill requires that plan administrators shall determine prior to distributing notice that any suspension, limitation or restriction is reasonable.
- The bill clarifies that notice is required only for suspensions longer than three consecutive calendar days and provides for specific exceptions to the 30 day rule. In the event of a qualified domestic relations order, or a blackout period caused by a merger or acquisition, only those employees who are impacted by the event will receive the notice.
- The bill provides that the Secretary shall issue guidance and model notices that include the above factors and such other provisions the Secretary may specify. Initial guidance will be no later than January 1, 2003. The Secretary may issue interim model guidance.
- The bill clarifies that notice may be electronic if reasonably accessible to the recipient.
- The bill provides that the Secretary may provide for additional exceptions to the requirements that are in the interest of participants and beneficiaries.

Inapplicability of Relief from Fiduciary Liability During Suspension of Ability of Participants to Direct Investments

- The bill explains fiduciary duty during blackout period. It clarifies that fiduciaries are not liable for losses provided that fiduciaries satisfy the requirements of this title.
- Relevant considerations in determining the satisfaction of fiduciary duty are also added, such as the provision of the blackout notice, the fiduciary's consideration of the reasonableness of the period of suspension, and the fiduciary's actions solely in the interest of participants and beneficiaries.

Diversification:

- The bill ensures that all employee contributions to pension plans will be immediately diversifiable.

- The bill provides for a five year transition rule for the allowable diversification of employer securities held in individual account plans as of the date of enactment.
- The bill provides for the option of a rolling three-year diversification of employer securities. In this case employer securities may be diversified three years after the calendar quarter in which they were contributed.
- The bill in general exempts individual account plans that do not hold employer securities that are readily tradable on an established securities market.

Investment Advice:

- The bill includes the text of H.R. 2269, the Retirement Security Advice Act, which provides increased availability of investment advisors to assist plan participants in making good decisions about their retirement assets.
- Employees will also be able to use pre-tax dollars to obtain their own investment advice.

Parity for Employees During Blackouts:

- The bill amends Section 16 the Securities and Exchange Act of 1934 to prohibit company executives and insiders from purchasing or selling any employer securities while plan participants and beneficiaries are precluded from directing or diversifying their accounts during a "blackout" period.

We are continuing to coordinate with the informal working group of State and local government organizations with CalPERS, and with the Governor's office in Washington in working with Congressional staff in the Senate – as the Finance Committee staff works to put together counterpart legislation—to clarify several technical aspects of these provisions.

Senate Legislation

The Senate continues to move more slowly in addressing the pension security issue. In the Senate, pension jurisdiction is split between the Finance Committee, chaired by Sen. Max Baucus (D-Mont.), which handles the tax side, and the Health, Education, Labor, and Pensions Committee, chaired by Sen. Edward Kennedy (D-Mass.), which handles the ERISA side. Senate pension efforts are less coordinated between the two Committees, as Chairman Kennedy already has moved ahead with introduction and mark-up of legislation while the Finance Committee continues to work to put together its own pension security package, which is expected to be more bipartisan.

a. Senate Labor Committee package

The Senate Health, Education, Labor, and Pensions Committee, chaired by Sen. Edward Kennedy (D-Mass.), has reported out its version of pension security legislation (S. 1992) on a sharply divided party line vote.

The Senate Labor Committee measure would permit continued use of employer stock matches and of company stock as an investment option, but not both. Employer requirements that plan assets be invested in employer stock would be barred.

Plan sponsors could designate independent investment advisors for participants, in accordance with certain guidelines. Pension benefit statements would be required on a quarterly basis.

The plan sponsor and plan administrator would have a new fiduciary duty under ERISA to provide each participant who exercise control over assets in his or her account with "all material investment information regarding investment of such assets to the extent that such information is generally required to be disclosed by the plan sponsor to investors in connection with an investment under the applicable securities laws."

The plan fiduciary could be sued under ERISA for breach of fiduciary duty. The fiduciary of an individual account plan having more than 100 participants would have to provide adequate insurance coverage for failure to comply with fiduciary duties. Liability for breach of fiduciary duty would be extended to other persons who participate in or conceal such breach.

Thirty days written notice would have to be provided in advance of any "lock-down", which could not continue for an unreasonable period of time.

Insider stock transactions would have to be disclosed promptly in electronic form.

Finally, in a significant and likely controversial change to ERISA, the Senate Labor Committee proposal requires that a single employer plan which an individual account plan covering more than 100 participants must be governed by a board of trustees, half of whom shall represent employer interests and half shall represent participant interests. In the case of collectively-bargained plans, the trustees representing employee interests are to be determined by election in which all participants may participate.

b. Senate Finance Committee proposal

There still isn't one yet. The Republican and Democratic staffs have been meeting in an effort to develop a bipartisan pension package. Chairman Baucus had hoped to introduce and mark-up bipartisan pension security legislation before Congress leaves for the Memorial Day recess at the end of May. However, the Finance Committee has had its attention diverted to a number of other a number of other major initiatives, including energy, trade, and Medicare prescription drugs, and hence Finance Committee action on pension security legislation may slip into June.

The Senate Finance package is expected to cover many of the same areas as the House Ways and Means measure that was merged into H.R. 3762 that passed the House.

Senate Majority Leader Daschle then will face the challenge of melding together the controversial Senate Labor Committee package, which was adopted on a straight party-line vote, and the more moderate, likely bipartisan Finance Committee package.

Elk Hills Compensation

We are continuing our year-long effort to pursue the necessary Congressional appropriation of the fifth \$36 million installment of Elk Hills compensation due for FY 2003, working with our House champion, House Ways and Means Committee Chairman Bill Thomas (R-Bakersfield) and our Senate champion, Sen. Dianne Feinstein (D-Ca.).

The year got off to a good start on this issue when President Bush requested the necessary appropriation for the fifth installment of Elk Hills compensation in his budget request to Congress for FY 2003.

After a more than month-long effort, we are pleased to report that we have secured the signatures of the entire 52 Member California House delegation on

a letter to the House appropriators in strong support of the appropriation for the fifth installment of Elk Hills compensation. (A copy of the letter is attached for your reference.) Although this is the fifth year in a row that we have managed to secure the signatures of all 52 California House Members on an Elk Hills delegation letter, each year is a new experience essentially starting from scratch, with unforeseeable “bumps in the road”, new Members of Congress, staffs that have turned over since last year’s letter and even turned over while we have been working on this year’s letter!

Once again, Rep. Thomas's leadership on this issue has been invaluable, and we are particularly grateful for his active help and the extensive work by his staff, given his time-consuming, high stakes duties as Chairman of the House Ways and Means Committee, which handles tax, pension, health, trade, and welfare legislation for the House of Representatives.

A request for the Elk Hills appropriation from all 52 California House Members having gone into the House appropriations leadership, the next step in the process is Committee mark-up of the Interior Appropriations legislation for FY 2003 by the House Interior Appropriations Subcommittee, chaired by Rep. Joe Skeen (R-N.M.). That mark-up is not expected until at least June, and may not occur until well into the summer.

On the Senate side, Sen. Dianne Feinstein (D-Ca.) sits on the Senate Interior Appropriations Subcommittee which will consider the Elk Hills issue. We have worked well with her staff on this issue over the years and will continue to coordinate with her office.

In addition, the Governor’s office in Washington continues to provide useful assistance on this project. We understand Elk Hills was included prominently on the Governor’s list of appropriation requests to Congress.

John S. Stanton

Washington, D.C.
May 13, 2002

Congress of the United States
Washington, DC 20515

April 18, 2002

The Honorable Joe Skeen
Chairman
Appropriations Subcommittee on Interior
B-308 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Chairman:

We are writing to urge the appropriation of \$36 million for FY 2003 to pay the State of California the fifth annual installment of compensation that is necessary to fulfill the Federal Government's obligation under its Settlement Agreement with the State regarding the Elk Hills Naval Petroleum Reserve.

In the Defense Authorization Act for FY 1996 authorizing the sale of the Elk Hills Reserve to private industry, Congress acknowledged the State of California's longstanding claims to the State school lands located within the Reserve by setting aside a portion of the proceeds from the sale of Elk Hills to settle the State's claims and directing the Secretary of Energy to negotiate a settlement of the State's claims. The Settlement Agreement that resulted between the Federal Government and the State enabled the Federal Government to maximize the sales revenues for the Federal taxpayer by removing the threat of the State's claims in advance of the sale, as well as any ability of the State to interfere with the sale. In return, the Settlement Agreement provided proper compensation to the State, as Congress had directed, for these lands that had been granted to the State at the time of its admission to the Union. The Settlement Agreement obligates the Federal Government to make installment payments of compensation to the State over a seven-year period without interest.

The State of California has kept its part of the bargain under the Settlement Agreement by removing the cloud of the State's claims, which enabled the Federal Government to sell the Elk Hills Reserve for \$3.65 billion, substantially more than had been anticipated. The funds necessary to compensate the State are there, having been collected from the sales proceeds and are now being held in an escrow fund in the Federal budget for the express purpose of compensating the State, as Congress had directed.

In 1998, 1999, 2000, 2001, and now for the fifth time, the California House delegation has written to the Chairman of the Appropriations Subcommittee on Interior in strong support of the Elk Hills appropriation. Congress has appropriated each of the first four annual installments

of compensation due to the State. We strongly urge the appropriation of \$36 million for FY 2003 to pay to the State of California the fifth annual installment of compensation to fulfill the Federal Government's obligation under the Settlement Agreement with the State regarding the Elk Hills Naval Petroleum Reserve.

Best regards,

Bill Thomas

Sam Fane

John T. Doolittle

Jane Harman

Nina Shoo

Grace F. Kaputano

Dana Rohrabacher

Henry A. Waxman

George Miller

Randy L. Dorn

Joe Baca

Art C. Levin

Zoe Lofgren

Edon L. Lofgren

Bob Filner

Maxine Waters

Mary Bond

Jerry L.

Pete Stark

Uma Horn

Stephen Horn

Mike Thompson

Mike Horn

Lauren Boone

Lois Capps

Aaron Davis

Tom Lanto

Ken Allard

Lynn Woolsey

Ch Cox

Lucille Keybal-Allard

Gay Bellard

David Drinn

Janet Hollander

Ellen Dauscher

Will

Cal Dooley

Diane E. Watson

Bud McLean

Wally Henger

Hilda L. Solis

El Royce

Nancy Pelosi

Coretta Sanchez

Richard Pombo

Howard L. Berman

~~Chuck~~

Gay Bill

Barbara Lee

Robert J. Matsui

Jerry Lewis

Brad Sherman

SUMMARY OF FEDERAL LEGISLATION AFFECTING CalSTRS

CORPORATE GOVERNANCE

BILL/ SPONSOR	STATUS (5/14/02)	SUMMARY (AS DESCRIBED IN TITLE)
S. 2460 (Levin)	Senate Committee on Banking, Housing, and Urban Affairs	A bill to guarantee persons who invest in publicly held companies accurate information about the financial condition of such companies so they can make fully informed investment decisions, to increase the independence of the Financial Accounting Standards Board, and for other purposes.

INVESTOR PROTECTION AND ACCOUNTING OVERSIGHT

BILL/ SPONSOR	STATUS (5/14/02)	SUMMARY (AS DESCRIBED IN TITLE)
* S. unnumbered (Sarbanes)	Not introduced	Would establish a stronger accounting oversight board than under the House legislation, seeks to promote greater independence of outside auditors, provides for reforms in corporate governance and financial disclosure.
* H.R. 3763 (Oxley)	Senate Committee on Banking, Housing, and Urban Affairs.	To protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes
S. 2004 (Dodd)	Senate Committee on Banking, Housing, and Urban Affairs	A bill to improve quality and transparency in financial reporting and independent audits and accounting services, to designate an Independent Public Accounting Board, to enhance the standard setting process for accounting practices, to improve Securities and Exchange Commission resources and oversight, and for other purposes.

* Key legislation for the issue

SECURITIES FRAUD LITIGATION

BILL/ SPONSOR	STATUS (5/14/02)	SUMMARY (AS DESCRIBED IN TITLE)
* S. 2010 (Leahy)	Senate Legislative Calendar under General Orders	To provide for criminal prosecution of persons who alter or destroy evidence in certain Federal investigations or defraud investors of publicly traded securities, to disallow debts incurred in violation of securities fraud laws from being discharged in bankruptcy, to protect whistleblowers against retaliation by their employers, and for other purposes.

PENSION SECURITY

BILL/ SPONSOR	STATUS (5/14/02)	SUMMARY (AS DESCRIBED IN TITLE)
H.R. 2269 (Boehner)	Senate Committee on Finance	Would amend Title I of ERISA and the Internal Revenue Code to promote the provision of retirement investment advice to workers managing their retirement income assets.
H.R. 3657 (Miller)	House Committee on Education and the Workforce	Would amend ERISA to provide for improved disclosure, diversification, account access, and accountability under individual account plans.
H.R. 3669 (Portman / Cardin)	Committee of the Whole House	Would amend the Internal Revenue Code to empower employees to control their retirement savings accounts through new diversification rights, new disclosure requirements, and new tax incentives for retirement education.
* H.R. 3762 (Boehner- Johnson)	Senate Committee on Health, Education, Labor, and Pensions.	Would amend Title I of ERISA and the Internal Revenue Code to provide additional protections to participants and beneficiaries in individual account plans from excessive investment in employer securities and to promote the provision of retirement investment advice to workers managing their retirement income assets, and to amend the Securities Exchange Act of 1934 to prohibit insider trades during any suspension of the ability to plan participants or beneficiaries to direct investment away from equity securities of the plan sponsor
S. 1919 (Wellstone)	Senate Committee on Health, Education, Labor, and Pensions	Would amend the Employee Retirement Income Security Act of 1974 to provide for improved disclosure, diversification, account access, and accountability under individual account plans.

S. 1971 (Grassley)	Senate Committee on Finance	Amends the Internal Revenue Code and the ERISA of 1974 to protect the retirement security of American workers by ensuring that pension assets are adequately diversified and by providing workers with adequate access to, and information about, their pension plans, and for other purposes
* S. 1992 (Kennedy)	Senate Health, Education, Labor, and Pensions	Amends the ERISA of 1974 to improved diversification of plan assets for participants in individual account plans, to improved disclosure, account access, and accountability under individual account plans, and for other purposes
S. 2190 (Kerry- Snowe)	Senate Committee on Finance	Would amend ERISA and the Internal Revenue Code to provide employees with greater control over assets in their pension accounts by providing them with better information about investment of the assets, new diversification rights, and new limitations on pension plan blackouts, and for other purposes.

CONFIDENTIALITY OF SOCIAL SECURITY NUMBER PROVISIONS

BILL/ SPONSOR	STATUS	SUMMARY (AS DESCRIBED IN TITLE)
H.R. 220 (Paul)	House Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations	Would amend Title II of the Social Security Act and the Internal Revenue Code of 1986 to protect the integrity and confidentiality of Social Security account numbers issued under such title, would prohibit the establishment in the Federal Government of any uniform national identifying number, and would prohibit federal agencies from imposing standards for identification of individuals on other agencies or persons.
H.R. 2036 (Shaw / Clay)	House Subcommittee on Financial Institutions and Consumer Credit, for a period to be subsequently determined by the Chairman	Would amend the Social Security Act to enhance privacy protections for individuals, to prevent fraudulent misuse of the Social Security account number, and for other purposes.
S. 324 (Shelby)	Senate Committee on Banking, Housing, and Urban Affairs	A bill to amend the Gramm-Leach-Bliley Act, to prohibit the sale and purchase of the social security number of an individual by financial institutions, to include social security numbers in the definition of nonpublic personal information, and for other purposes.

S. 451 (Nelson)	Senate Committee on Finance	A bill to establish civil and criminal penalties for the sale or purchase of a Social Security number.
S. 848 (Feinstein)	Senate Committee on the Judiciary	A bill to amend Title 18, United States Code, to limit the misuse of Social Security numbers, to establish criminal penalties for such misuse, and for other purposes.
S. 1014 (Bunning)	Senate Committee on Finance	To amend the Social Security Act to enhance privacy protections for individuals, to prevent fraudulent misuse of the Social Security account number, and for other purposes.

SOCIAL SECURITY OFFSET REDUCTION PROVISIONS

BILL/ SPONSOR	STATUS	SUMMARY (AS DESCRIBED IN TITLE)
H.R. 664 (Jefferson)	House Subcommittee on Social Security	Would amend Title II of the Social Security Act to provide that the reductions in Social Security benefits which are required in the case of spouses and surviving spouses who are also receiving certain government pensions shall be equal to the amount by which the total amount of the combined monthly benefit (before reduction) and monthly pension exceeds \$1,200.
H.R. 848 (Sandlin)	House Subcommittee on Social Security	Would amend Title II of the Social Security Act to eliminate the provision that reduces primary insurance amounts for individuals receiving pensions from non-covered employment.
H.R. 1073 (Frank)	House Subcommittee on Social Security	Would amend Title II of the Social Security Act to restrict the application of the Windfall Elimination Provision to individuals whose combined monthly income from benefits under such title and other monthly periodic payments exceed \$2,000 and to provide for a graduated implementation of such provision on amounts above \$2,000.
H.R. 2462 (Brady)	House Committee on Ways and Means	Would amend the Internal Revenue Code of 1986 to provide an exclusion from gross income for that portion of a governmental pension received by an individual which does not exceed the maximum benefits payable under Title II of the Social Security Act which could have been excluded from income for the taxable year.
H.R. 2638 (McKeon)	House Subcommittee on Social Security	Would amend Title II of the Social Security Act to repeal the Government Pension Offset, and Windfall Elimination Provision
H.R. 3497 (Shaw)	House Committee on Ways and Means	Would amend the Social Security Act and the Internal Revenue Code of 1986 to preserve and strengthen the Social Security program through the creation of personal Social Security guarantee accounts ensuring full benefits for all workers and their families, restoring long-term Social Security solvency, to make certain benefit improvements, and for other purposes.

S. 611 (Mikulski)	Senate Committee on Finance	Would amend Title II of the Social Security Act to provide that the reductions in Social Security benefits which are required in the case of spouses and surviving spouses who are also receiving certain Government pensions shall be equal to the amount by which two-thirds of the total amount of the combined monthly benefit (before reduction) and monthly pension exceeds \$1,200, adjusted for inflation.
S. 1523 (Feinstein)	Senate Committee on Finance	Would amend Title II of the Social Security Act to repeal the Government Pension Offset, and Windfall Elimination Provision

INDIVIDUAL SOCIAL SECURITY ACCOUNT PROVISIONS

BILL/ SPONSOR	STATUS	SUMMARY (AS DESCRIBED IN TITLE)
H.R. 3535 (DeMint)	House Committee on Ways and Means	Would amend the Social Security Act and the Internal Revenue Code of 1986 to preserve and strengthen the Social Security program through the creation of individual Social Security accounts ensuring full benefits for all workers and their families, giving Americans ownership of their retirement, restoring long-term Social Security solvency, and for other purposes.

OTHER SOCIAL SECURITY PROVISIONS

BILL/ SPONSOR	STATUS	SUMMARY (AS DESCRIBED IN TITLE)
H.C.R. 120 (Green)	House Subcommittee on Social Security	Expressing the sense of the Congress that Social Security reform measures should not force State and local government employees into Social Security coverage.
H.C.R. 229 (Graves)	House Subcommittee on Social Security	Expresses the sense of the Congress that any reform of the Social Security program not include mandatory coverage of State and local employees